[Case Title]Klym, McClarty v Delta Dental Plan of MI
[Case Number]93-40362
[Bankruptcy Judge]Steven W. Rhodes
[Adversary Number]94-4313
[Date Published]November 10, 1994

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

IN RE:	UNPUBLISHED
ROBERT D. KLYM,	Case No. 93-40362-R
Debtor. _____/	Chapter 7
HOMER W. McCLARTY, Trustee,	
Plaintiff,	Case No. 94-4313-R
v.	Adversary Proceeding
DELTA DENTAL PLAN OF MICHIGAN, INC., A Michigan Corporation,	
Defendant. _____/	

OPINION REGARDING CROSS-MOTIONS FOR SUMMARY JUDGMENT

This matter is before the Court on the trustee's motion for summary judgment requesting that the Court rule that defendant's withholding of claim payments from the debtor violated §§ 547 and 549 as a matter of law. The defendant has also filed a motion for summary judgment arguing that the withholding of claim payments was a valid recoupment. The issue before the Court is whether the common law doctrine of recoupment is applicable to these proceedings. After hearing oral argument, the matter was taken under advisement. The Court now finds that genuine issues of material fact remain with

respect to the application of recoupment. Therefore, the respective motions for summary judgment are denied.

I.

On July 25, 1974, Dr. Klym, the debtor, entered into a Service Agreement with Delta Dental Plan of Michigan, Inc. ("Delta") whereby he would provide dental services for eligible Delta participants and Delta would reimburse him for claims submitted. The Service Agreement provided in pertinent part:

> It shall be a Uniform Requirement that a participating dentist authorizes [Delta] to deduct from any payments due him/her such sums as [Delta] reasonably determines to be properly due and owing to [Delta] as a refund of payments made incorrectly to or claimed by the dentist provided that the dentist has been notified by [Delta] that a refund is due and that the dentist has not refunded the amount due.

In July, 1991, Delta implemented a new computer processing system. This initially resulted in delays in payment to Delta's participating dentists. Therefore, Delta decided to offer a supplemental payment plan to assist its participating dentists who were experiencing delays in claims processing. Under the plan, Delta offered interest-free payment advances to any participating dentist whose year-to-date receipts fell below their receipts for the previous year. Delta sent a letter announcing this program to all participating dentists on September 26, 1991. The promissory notes attached to the payment

applications provided in part:

> . . . the undersigned hereby promises to pay to Delta Dental Plan of Michigan, Inc. (the "Payee"), the said amount without interest, not later than 180 days from the date the note is issued. The principal of this Promissory Note shall be due and payable at Okemos, Michigan and, in Payee's discretion, may be offset against current or future indebtedness of Payee to the undersigned.

The notes further provided that if the loans were for a solo practitioner, the dentist's signature was required. If the loans were for a partnership or professional corporation, an authorized officer was required to sign the note. Dr. Klym completed and signed payment applications for each of the dental practices in Michigan in which he was a shareholder.[1]

In October, 1991, Delta issued five separate checks totaling $56,527 to Robert Klym, D.D.S., corresponding to the applications he submitted on behalf of each dental practice. The trustee states that Dr. Klym deposited the checks into the individual bank accounts of each dental practice.

On February 6, 1992, Delta sent five separate letters to Dr. Klym regarding repayment of each of the loans. Each letter referenced the tax identification number of the dental practice that the loan related to and stated that repayment of the loan was due on April 5, 1992. The

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1 Dr. Klym was a shareholder of the following dental practices: Grand Blanc Dental Group, P.C.; Robert D. Klym, D.D.S., P.C.; St. Helen Family Dental Center, P.C.; Byron Family Dental Center, P.C.; and West Branch Family Dental Center, P.C.

loans were not repaid by the due date.

On August 26, 1992, Delta sent letters to Dr. Klym indicating that it was extending the due date on the advances to December 1, 1992. The letters further stated that any amount outstanding after December 1, 1992 would be deducted through its automatic deduction process, meaning that Delta would withhold the full amount of any claim payments due Dr. Klym until complete repayment was made.

Dr. Klym failed to repay the advances and in December, 1992 Delta began to withhold payment on claims due Dr. Klym to offset the indebtedness.

On January 14, 1993, Dr. Klym filed his Chapter 7 petition for relief. Delta continued to withhold claim payments from Dr. Klym after the petition was filed. In total, Delta withheld $8,377.21 pre-petition and $19,801.88 post-petition.

On March 2, 1994, the trustee for Dr. Klym moved the Court for an order requiring Delta to turn over to the trustee the $8,377.21 as a preferential transfer under § 547 and the $19,801.88 as a voidable post-petition transfer under § 549. In response, Delta asserts that the transfers constitute permissible recoupments for overpayments made to Dr. Klym.

II.

Delta argues that it has both an equitable and a contractual right to recoupment. Delta points to the language in the Service Agreement that specifically gives it the right to recover any payments incorrectly made to Dr. Klym. Delta contends that the advances made pursuant to the promissory notes became overpayments when Delta completed processing and payment of all charges submitted by Dr. Klym. As such, Delta asserts that it was permitted to recover the overpayments by withholding claim payments otherwise due and owing to Dr. Klym. Moreover, Delta argues that the advances were at all times subject to its superior right of recoupment.

The trustee argues that recoupment does not apply because Delta's claim and Dr. Klym's claim do not arise out of the same transaction. Delta's claim arose from the promissory notes for advances signed by Dr. Klym in October of 1991. Dr. Klym's claim for payment arose from services performed by him during and after December of 1992. This, the trustee argues, clearly does not satisfy the "same transaction" requirement for recoupment.

III.

Recoupment "is the setting up of a demand arising from the *same transaction* as the plaintiff's claim or cause of action, strictly for the purpose of abatement or reduction of such claim." 4 Collier on Bankruptcy ¶ 553.03, at 553-15 (Lawrence P. King ed., 15th ed. 1992)

(footnote omitted).

It is important to distinguish recoupment from the creditor's right to set off certain claims. The doctrine of setoff, as incorporated in Bankruptcy Code § 553, allows for setoff of mutual pre-petition debts between the creditor and the debtor under certain limited circumstances. In re Ruiz, 146 B.R. 877 (Bankr. S.D. Fla. 1992). "Setoff, in effect, elevates an unsecured claim to secured status, to the extent that the debtor has a mutual pre-petition claim against the creditor." Lee v. Schweiker, 739 F.2d 870, 875 (3d Cir. 1984). Generally, the mutual debt and claim are the product of different transactions. 4 Collier on Bankruptcy ¶ 553.03, at 553-14 (Lawrence P. King ed., 15th ed. 1992).

Recoupment, on the other hand, involves claims arising from the same transaction. The doctrine is justified on the grounds that "where the creditor's claim against the debtor arises from the same transaction as the debtor's claim, it is essentially a defense to the debtor's claim against the creditor rather than a mutual obligation, and application of the limitations on setoff in bankruptcy would be inequitable." Lee at 875. In the bankruptcy context, the doctrine of recoupment has often been applied where the creditor's claim against

the debtor and the debtor's claim against the creditor arise out of a single contract "that provide[s] for advanced payments based on estimates of what ultimately would be owed, subject to later correction." In re B & L Oil Co., 782 F.2d 155, 157 (10th Cir. 1986). However, an express contractual right is not necessary to effect recoupment. See In re Holford, 896 F.2d 176, 178 (5th Cir. 1990). Nor does the fact that a contract exists between the debtor and creditor create an automatic right to recoupment. See In re University Medical Center, 973 F.2d 1065, 1080 (3d Cir. 1992).

The Court is unable to determine whether recoupment is applicable here due to the following factual disputes. First, it is not clear that Delta has an enforceable claim against Dr. Klym. Delta asserts that because Dr. Klym signed all of the promissory notes and the advance checks were issued directly to him, he is personally liable. The trustee argues that Dr. Klym signed the notes as an authorized representative of each individual dental practice, and therefore the advances were the liability of the dental practices, not Dr. Klym.

Second, it is not clear whether the pre-petition withholdings were from Dr. Klym or from the Robert D. Klym, D.D.S., P.C., a nondebtor entity. Delta states that it properly withheld claim payments due to Dr. Klym to satisfy overpayments made to Dr. Klym. However, copies of checks submitted with the pleadings show that the pre-petition withholdings were from the Klym, P.C., not Dr. Klym personally. If the

pre-petition withholdings were from the Klym, P.C. as opposed to the debtor, it would not be property of the debtor's estate, and therefore not subject to recovery by the trustee.

Recoupment is only appropriate in situations where the claims arise from the same transaction. Prior to determining whether the claims arose from the same transaction, the Court must determine, among other things, whether each of the parties before it has a claim against the other. Here, there is a genuine issue of fact as to whether Dr. Klym is liable for payment on these promissory notes. While cross-motions for summary judgment may be probative of the nonexistence of a factual dispute, when the parties disagree as to facts and take inconsistent legal theories, the mere filing of cross-motions for summary judgment does not warrant entry of such judgment. Shook v. United States, 713 F.2d 662, 665 (11th Cir. 1983).

Accordingly, both motions for summary judgment are denied.

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STEVEN W. RHODES
U. S. BANKRUPTCY JUDGE

Entered: _____